Nos. 1108-10

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Supreme Court of the United States

October Term, 1945

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, ET AL.

vs.

FORT SCOTT BONDHOLDERS' COMMITTEE, ET AL.

Brief for Respondents in Opposition to Petition for Writs of Certiorari

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Dated May 3, 1946

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RECORD REFERENCES

A.—The Appendix to the Petition

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Brief for Respondents in Opposition to Petition for Writs of Certiorari

OPINION OF COURT BELOW

The opinion of the court below (the Circuit Court of Appeals for the Eighth Circuit), printed at R. 184, is reported at 153 F. 2d 312.

JURISDICTION

The date of the orders sought to be reviewed is February 8, 1946.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C., Sec. 347).

STATEMENT

This case involves a plan for the reorganization of a railroad under Section 77 of the Bankruptcy Act.

The road has been in reorganization every 20 years. Originating in a reorganization in 1876, it went through reorganization again in 1896 and 1916 and returned for further reorganization, slightly ahead of schedule time, in 1932. As the Commission said in 1938, the Debtor has

> "always suffered, among other things, from overcapitalization in the worst sense of the word."[1]

After repeated hearings on a plan under Section 77, and on a full record, the Commission found in July, 1940, that "the total capitalization after reorganization should be

[1] 52nd Annual Report of the Interstate Commerce Commission to the Congress, dated November 1, 1938, p. 4.

about $240,000,000" (A. 44). The plan so approved was disapproved by the District Court on the ground of preferential treatment of certain claims that were later purchased by the estate in a compromise settlement (A. 73-74). On remand to the Commission a further hearing was held in February, 1944. In the light of the court's opinion that the Commission was free to increase the total new capitalization (Pro. 6015, 6017), evidence was introduced as to war earnings through 1943, new traffic sources, improvements to the property, and future prospects. On this modernized record the Commission found, in July, 1944, that some increase was permissible and that a total new capitalization of 248 million dollars should be approved (A. 82).

But this was far less than the claims of bondholders. The deficiency exceeded 110 million dollars, as shown in the following table:

	Old Capitalization of Debtor (in 000's)	*New Capitalization under Plan (in 000's)*
Fixed interest lien debt	$359,444[2]	$ 76,371
Contingent interest lien debt	———	47,550
Total debt	366,029[3]	123,921
Preferred Stock	49,158	61,860
Common Stock	65,543	62,058
	$480,731	$247,839

So the Commission found that the claims of general creditors and the interests of holders of the old stock were without value and they should receive nothing under the Plan (A. 82). The Plan was then certified to the District Court.

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[2]This figure as stated in Plan, less the cash required to be paid out by the Plan. The other figures as stated in Plan (A. 91). The old capitalization is stated as of January 1, 1944; it is greater as of any later date, because cash distributions were less than interest accruals.

[3]There was no unsecured debt except a minor amount of claims of general creditors, including the petitioners in Nos. 1108-9, some of which may have been secured by junior liens.

The Debtor objected there that (*i*) new capitalization should be larger and (*ii*) interest should not be recognized on the bonds at contract rates. These objections, concurred in by Brooks and Dikis, were overruled and the District Court approved the Plan (A. 97).

The Debtor, joined by Brooks and Dikis, appealed to the Circuit Court, again urging the same two questions as the mainstay of their case. They were overruled by the Circuit Court (R. 184) and the order of the District Court approving the Plan was affirmed (R. 195).

It is to review this action of the Circuit Court that certiorari is sought.

QUESTIONS PRESENTED

The basic questions presented here, as in the courts below, are:

1. Was the Circuit Court right in holding that there was warrant for the District Court to find that the Commission acted within its powers in fixing the total amount of the new capitalization?

2. Were the tribunals below right in holding that, in determining the new securities issuable in respect of mortgaged property, the bondholders are entitled to recognition not only for their principal, but also for their unpaid interest accrued at contract rates?

Minor questions presented here, and also below, are:

3. Were the tribunals below right in holding that there are in this case no unmortgaged assets?

4. Was the Circuit Court right in disposing of these appeals from the order approving the Plan despite the pendency of a later appeal from an order confirming the Plan, where the later appeal raises no substantial issue?

In addition the Petition seeks to present here numerous arguments against the reorganization pattern of Section 77. Many were not presented to any tribunal below and none is pertinent to any ruling or issue below unless in some such way as this:

5. Was the Circuit Court right in refusing to reject the statutory scheme of Section 77 because of arguments that if the Congress had said something different, resourceful management might conceivably have been able to achieve some different result, or because of the possibility that the Congress may still say something different?

ARGUMENT

1.

The Amount of the Total New Capitalization in this Case is a Matter of no General Interest

There is nothing novel in the standard applied by the Commission here. It is the familiar standard, long applied in equity practice and lately established by this Court as the intention of Section 77,[4] by which all circumstances are considered, including even the elements of physical value, but primary weight is given to prospective earning capacity, in order, as the Commission said here, that the new securities may be such as

> "would give the holders thereof some prospect of interest or dividends, and would otherwise be compatible with the public interest" (A. 45).

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[4] *Ecker* v. *Western Pacific R.*, 318 U. S. 448, 483 (1943) [cited as *Western Pacific Case*]; *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R.*, 318 U. S. 523, 539-41 (1943) [cited as *Milwaukee Case*].

It was manifest to the Circuit Court that this was merely another application of the principles declared in the *Western Pacific Case* and the *Milwaukee Case*. Nothing need be added to the Circuit Court's discussion on that point (R. 187-92).

This is not the place to review the sufficiency of the evidence to make a basis for Commission power to reach the particular result it did in this particular case. That would put no question of general interest. If a question of general interest could conceivably arise on such a point in any case, it does not here. Reported earnings in the period 1921-1943, after Federal income taxes at 35%, failed by 27 million dollars to cover the indicated return on the new senior securities and dividends at 6% on the new Common Stock, without any provision for improvements to the property. Since 1943, the last full year before the Commission when it acted, net earnings have declined as cost levels have notoriously mounted. The entire net current assets[5] are less than half the bondholders' unrecognized claim. It is, in short, a typical case for finality of administrative judgment.

2.

The Bondholders' Right to Interest is Settled Law

Each of the mortgages is in terms security for interest as well as principal,[6] and together they cover the whole system (R. 193). In such circumstances it is settled law that no junior interest can participate until the bondholders receive full satisfaction, not only for their principal, but also for their unpaid interest accrued at contract rates. This rule is

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[5]41 million dollars at September 30, 1945 (R. 179).

[6]Ex. 13, p. 45; Ex. 14, p. 102; Ex. 15, p. 165 (all in the original, unprinted transcript).

settled in equity,[7] in bankruptcy,[8] under Section 77B[9] and under Section 77.[10] It is admitted in the Petition with respect to satisfaction of bondholders' claims out of their security (p. 27), and as said above, the liens cover everything here. The distributions made during the proceeding are applicable to accrued interest, and not to principal, by the express terms of the mortgages.[11] Prior rights are enforced against general creditors as well as stockholders.[12] There is no question on these matters to review.

3.

There are no Unmortgaged Assets

The only asset that the Petition claims to be unmortgaged is the 1.3 million dollars of cash that was on hand when receivers were appointed on November 1, 1932 (Petition, pp. 5, 20), a sum, it is asserted, which "The Trustee of the District Court has in hand" (*id.* p. 5). But the record shows that current claims of more than twice that amount, including 1.6 million dollars of pay-roll alone, were accrued and unpaid on November 1, 1932, and were in fact paid during that month (Pro. 188-9). It is to be presumed that cash on hand at the inception of receivership was applied to current

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[7]*American Iron and Steel Mfg. Co.* v. *Seaboard Air Line R.*, 223 U. S. 261, 266-7 (1914); *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 412, 413 (1938).

[8]*Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 597, n. 30 (1935); *Ticonic National Bank* v. *Sprague*, above.

[9]*Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 527 (1941).

[10]*Western Pacific Case*, 318 U. S. at 509-10; *Milwaukee Case*, 318 U. S. at 546.

[11]Ex. 13, pp. 38-39; Ex. 14, p. 95; Ex. 15, p. 157 (all in the original, unprinted transcript). The cited provisions deal with possession by the indenture trustee, but the debtor trustee holds for him.

[12]*Western Pacific Case*, 318 U. S. at 483; *Milwaukee Case*, 318 U. S. at 569.

claims then accrued and payable. Clearly such cash is the fund primarily chargeable with the payment of such claims.[13]

4.

The Circuit Court was not Barred from Deciding the Case by Petitioners' Later Unfounded Appeal

On submission of the Plan for a vote of creditors pursuant to Section 77(e), it was accepted by all voting classes (R. 195 and Pro. 7887). Section 77(e) requires that:

> ". . . the judge shall confirm the plan if satisfied that it has been accepted by . . . [the statutory vote] and that such acceptances have not been made or procured by any means forbidden by law . . ."

If the plan has not been so accepted, the judge may nevertheless confirm it if, upon a review of the merits of the plan, he again finds that it is fair and equitable and otherwise in conformity with the statutory requirements (subdivision (e) of Section 77). But as the quoted words show, and as this summary of the adjoining proviso emphasizes, the judge has no concern with the merits of a plan accepted by all voting classes. He is required to confirm it if the procedure of voting was lawful.

This was pointed out to the Circuit Court and is so held in its opinion (R. 195). It is not questioned by Petitioners, either below or here.

Yet the Petition makes no suggestion of illegality in the procedure of voting, though that is the only statutory issue. It is rightly silent in this respect, for we vouch the record to show that no such suggestion was made at the hearing on confirmation of the Plan.[14] It seems clear, therefore, that

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[13] *Guaranty Trust Co.* v. *Albia Coal Co.*, 36 F. 2d 34 (C.C.A. 8, 1929).

[14] This hearing was after the preparation of the record in the appeals below, and is not of record here.

no issue can be presented by Petitioners' appeals from the confirmation order. The entire merits, in short, arise in these appeals from the approval order, and the appeals from the confirmation order are a mere technicality.

The fact that the Circuit Court is deferring action on Respondents' motion to dismiss the appeals from the confirmation order until the Petition is disposed of is entirely irrelevant to the merits of the Petition. The Circuit Court itself found no reason to defer action on the approval order until disposition of the insubstantial appeals from the confirmation order. On the contrary, as it rightly said (R. 195):

> "If the plan has been accepted and the acceptance has been properly obtained, it will then be confirmed. In the instant case, the plan has already been accepted by more than two-thirds of those voting in each class to which submission was required. Certainly, in those circumstances there should be no further delay in this proceeding which has already been pending for more than twelve years."

This was altogether unlike the situation presented to the Circuit Court in *In re Denver and Rio Grande Western R.*, 150 F. 2d 28 (C.C.A. 10, 1945), *cert. granted*, 90 L. Ed. *32 (1945, cited in Petition p. 18). There one of the voting classes had rejected the plan, so its merits were again to be reviewed on the issue of confirmation. Accordingly that court, having to consider the merits on two sets of appeals, decided them together, as a matter of its own convenience, without professing to lay down any rule of general application.

5.
Petitioners' Other Arguments Lie Merely in the Realm of Debate

The obscure invocation of "extraordinary powers" in the Petition (p. 22) apparently looks to some financial experimentation, by which the court, instead of approving or disapproving a Commission plan, as Section 77 directs, would seek to whittle down the claims of creditors, by purchases of bonds at a heavy discount during a default in interest, etc., for the purpose of re-establishing a vanished equity. But these are not complaints against a disapproval below of any particular proposal. In fact none was made. They are merely arguments that conceivably the Congress might have provided some reorganization pattern other than what it did.

Changes in Section 77 are currently being discussed in the Congress (Petition, p. 22 and Appendix B). But such discussion is not a way of trying the issues in any particular case, for there is no full hearing or opportunity to reply in the judicial sense. For that matter, the Congress does not purport to exercise the judicial function, indeed could not constitutionally do so. That such discussion may eventuate in some change in the law is mere speculation. Until the Congress enacts new legislation, Section 77 remains the governing statute.

It is equally a mere matter of debate whether the Debtor is entitled to represent unsecured creditors not directly represented by their own counsel. We see nothing in the Circuit Court's opinion or decision that denies the asserted right, and we think it an academic question here, which this Court has no reason to decide, whether the Debtor may or may not speak for people who are not entitled to receive anything.

CONCLUSION

The Petition should be denied.

Dated May 3, 1946.

Respectfully submitted,

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